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No. 80-1562

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980

MARINE BANK, PETITIONER

v.

SAMUEL WEAVER AND ALICE WEAVER, RESPONDENTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR MYRNA AYALA AS AMICUS CURIAE IN SUPPORT OF THE RESPONDENTS

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QUESTIONS PRESENTED

1. Whether a certificate of deposit issued by petitioner, a state bank subject to federal regulation, is a security subject to the antifraud provisions of the federal securities laws.

2. Whether an agreement whereby the respondents were entitled to a share of the profits of an enterprise, and certain other benefits, in consideration of a pledge of the respondents' certificate of deposit to the petitioner, is a security subject to the antifraud provisions of the federal securities laws.

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BRIEF FOR MYRNA AYALA AS AMICUS CURIAE IN SUPPORT OF THE OTHER RESPONDENTS

Interest of Amicus

Myrna Ayala, the amicus herein, is the representative of a class of roughly 100,000 investors in time certificates of deposit issued by a mutual savings bank in New York.[1] These instru-

[1] In *Ayala v. Jamaica Savings Bank*, (1981) Fed. Sec. L. Rep., par. 98,041 (CCH), the bank led investors to believe that their CD's could be redeemed at any time, subject to a penalty. Then without any notice, the bank refused all requests for redemption. As a result investors' funds were frozen and unavailable for extended terms, and at interest rates considerably below those available from competitive instruments.

Most banks in the New York area honored their representations and allowed their CD's to be redeemed. In full-page newspaper ads, however, Jamaica Savings Bank proudly announced that despite the high cost of funds, its earnings had suffered less than those of other banks due to "prudent and conservative policies".

The FDIC has a regulation (12 C.F.R. 329.4(f)) requiring banks to advise their CD investors, in a separate written statement, that their funds might be locked in. Apparently, this requirement has been totally ignored, especially by Jamaica. The FDIC has informally indicated that it considers it more important for banks to be able to lock in funds than for investors to be warned of this possibility.

ments are substantially similar to the certificate of deposit ("CD") acquired from and pledged to Marine Bank by the Weavers. Ms. Ayala believes CD's to be securities entitled to the protections of the Securities Acts of 1933, 15 U.S.C. 77a et seq. (" '33 Act"), and Securities Exchange Act of 1934, 15 U.S.C. 78a et seq. (" '34 Act"). The outcome of this case may determine the outcome of her claims as well.

CD's are simply i.o.u.'s issued by a bank. With limited exceptions, they are promises to pay a certain sum at a certain time together with interest at a certain rate. The only difference between CD's and treasury bills or corporate notes is that CD's are issued by a bank.

The term "CD" is generically applied to several types of bank instruments with various maturities, various terms and conditions, and various interest rates. Some are insured and some are partially insured. Banks also issue similar instruments that are not insured.

In the aggregate, there are hundreds of billions of dollars worth of CD's outstanding at any given time, held by tens of millions of individuals and institutions. Unless the Court's decision is confined very narrowly to the particular facts of this case, these individuals and institutions, as well as tens of thousands of banks, will be significantly affected. Moreover, the reasoning of the Court in even a narrow decision will necessarily provide the basis for countless decisions and transactions. This explains the interest this case has drawn from the American Bankers Association and four government agencies (collectively, the "Government").

Up until this case, the Securities and Exchange Commission ("SEC"), the independent regulatory agency that administers the '33 and '34 Acts, has consistently maintained, in rulings[2] and

[2] In a letter from the Administrator of National Banks to the presidents of all national banks on December 16, 1966, 31 Federal Register 16581, banks were advised that "The Securities and Exchange Commission has expressed the opinion that deposit and share accounts are subject to the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 and that advertisements by financial institutions that are contrary to such principles may violate those anti-fraud provisions."

in court,[3] that CD's are securities as defined by those Acts. On August 6, 1981, the Fifth Circuit Court of Appeals, taking heed of the SEC's arguments, reversed a lower court ruling that CD's were not securities.[4]

Without the SEC, there is no one left besides the respondents to assert the interest of individual investors in retaining the remedies and protections of the federal securities laws other than individual investors themselves. The federal bank agencies, as will be shown, lack the tools and authority for this purpose, and in the past, thei solicitude for complaining investors has not been notable. Whether or not the claims of Ms. Ayala's class are typical of those of other purchasers or sellers of bank instruments, these claims bear witness to the fact that claims do arise from time to time, either against banks as sellers or issuers of bank securities or against other persons having some nexus with the purchase and sale of bank securities.

Like the respondents, we believe CD's to be "securities" when secondarily traded, but also, based on the statutes, their legislative history, and the rulings of this Court, at all other stages of their existence as well.

Statement of the Case

In February, 1978, the respondents, Samuel and Alice Weaver ("the Weavers") purchased a $50,000 six-year CD paying interest at 7.5% per annum from Marine Bank, a state bank regulated by Pennsylvania regulatory authorities and by the Federal Deposit Insurance Corporation ("FDIC"). CD's issued by Marine Bank are insured by the FDIC up to $100,000.

In March 1978, Marine Bank approached the Weavers to provide security for a loan by Marine Bank to Columbus Packing

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[3] See footnote 1 of the brief for the United States as Amicus Curiae. Hereinafter, the brief of the United States will be referred to as US Br., the brief of Marine Bank as MB Br. and the brief of the American Bankers Association as ABA Br.

[4] *Meason v. Bank of Miami*, __F.2d__No. 79-3607 (5th Cir. 1981).

Company, a local slaughterhouse and retail meat market owned by Raymond and Barbara Piccirillo ("Piccirillo"). According to the Weavers, they were led to believe that the loan was to provide working capital though, in fact, it would be used for the most part to pay off outstanding unsecured loans by Marine Bank, substantial overdrafts, and various priority creditors of the slaughterhouse. Marine Bank did not disclose the poor financial condition of the slaughterhouse to the Weavers, and disguised that condition by honoring overdrafts of the slaughterhouse to the Weavers.

Without appreciating the precarious position of the slaughterhouse, the Weavers pledged their CD as collateral for the "new" loan to the slaughterhouse. In consideration of their pledge, the Weavers obtained from Piccirillo an agreement to participate to the extent of fifty percent of the profits of the slaughterhouse, one hundred dollars a month, and the right to graze cattle on slaughterhouse property.

No sooner had the pledge been made than the situation deterioriated. Checks from the slaughterhouse to the Weavers were dishonored, within weeks the slaughterhouse was out of business, and Marine Bank initiated steps to apply the collateral to the outstanding balance of the "new" loan. In effect, the Weavers "sold" their CD to Marine Bank for nothing.

Summary of Argument

The fraud in this case is straightforward. Marine Bank was not a mere aider and abettor, but was the principal promoter and beneficiary of the scheme. Marine Bank's defenses are utterly repugnant to the federal securities laws, and if permitted, would nullify the effect of those laws.

The decision of the Third Circuit Court of Appeals is soundly based upon the structure, language, and purposes of the federal securities laws, as well as upon the economic realities of the financial markets. The coverage of the '33 and '34 Acts, being remedial in nature, was broadly written to include a wide range

of financial instruments. Narrow groups of these instruments are classified as "exempted securities" and relieved from compliance with some, but not all, of the provisions of the Acts. Not even "exempted securities" are excused from the antifraud provisions.

CD's are covered several times over in the definitional sections of the Acts, as notes, bonds, evidences of indebtedness, or investment contracts. Under the '33 Act (but not the '34 Act), securities issued or guaranteed by banks are exempted from the registration requirements of that Act, a meaningless exemption unless coverage existed to begin with.[5] As found by the Third Circuit, CD's are the functional equivalent of bonds or notes, and compete head to head with the increasing variety of financial instruments available to the public, many of them offered by banks themselves. The Court previously held savings accounts to be securities.[6] CD's are equally subject to that classification.

Marine Bank's principal argument, that the Court should override the express language and structure of the '33 and '34 Acts because CD's are "safe" and "regulated", misses the essential purpose of the Acts,

> "(T)o provide full and fair disclosure of the character of securities sold in interstate and foreign commerce

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[5] It was this rationale that, in part, led the Court to conclude that savings accounts of a state regulated savings and loan associations were securities, in *Tcherepnin v. Knight*, 389 U.S. 332 (1967). See also note 6, *infra*.

[6] In *Tcherephin v. Knight, supra* the Court held savings accounts in a savings and loan association to be securities. The securities there were called "withdrawable capital shares", but a savings account by any other name still has the same investment characteristics. In mutual savings and loan associations, holders of savings accounts, and even borrowers, get a vote.

Savings accounts are not fixed income instruments. Nothing prevents a bank from adjusting the returns, whether characterized as "dividends" or "interest", upward or downward or paying nothing at all, except for the availability of earnings of the bank and the upper limit imposed by the FDIC and Federal Savings and Loan Insurance Corporation ("FSLIC"). That upper limit is in the process being gradually eliminated under the Depository Institutions Deregulation Act of 1980, 12 U.S.C. Sec. 3501 et seq.

Nor are savings accounts especially liquid. Banks may, and often do, impose thirty day notice requirements on withdrawals.

> and through the mails, and to prevent frauds in the sale thereof. . ." 15 U.S.C. 77b (preamble).

A security itself may be perfectly safe, but that does not prevent mischaracterization of its value, terms, return, liquidity, resale market, tax attributes, or many other material features. It does not prevent mischaracterization of what is given or taken in exchange for a security or frauds generally in connection with securities.

Moreover this argument proves far too much. A nearly infinite range of securities which are "safe" and whose issuers are regulated could easily qualify by such a measure. Logically extended, this argument would eliminate antifraud protection in regard to many presently covered securities, such as treasury securities, state and municipal securities, securities issued or guaranteed by Federal or Government National Mortgage Associations, public utilities, insurance companies, common carriers, and many others.

Securities and bank regulatory statutes were enacted for different purposes. Bank regulation does not begin to provide an adequate substitute for the protections and remedies of the federal securities laws. Regulation in one respect does not mean regulation in all respects.

Nor is there any evidence that Congress intended bank regulation to be a substitute for federal securities law protection other than the explicit classification of bank securities as "exempted securities" for purposes of the registration provisions of the '33 Act. The coverage intended by Congress was clearly expressed in the '33 and '34 Acts in explicit, substantive provisions. The relationship with other laws was clearly expressed as well. The '33 and '34 Acts both provide that the rights and remedies provided therein "shall be in addition" to any and all other rights and remedies.

The net result of the transactions giving rise to this case was that Marine Bank acquired a valuable security from the Weavers in exchange for something worthless. The federal banking laws are no help to the Weavers, but this is precisely the type of situation intended to be covered by the federal securities laws.

Argument

I. The Structure, Language, and Purposes of the '33 and '34 Acts Require That CD's Be Considered Securities.

A. Structure

Both the '33 and '34 Acts begin with definitions of "security" that are

> "in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security."[7]

The American Bankers Association argues that the definition is an "exhaustive" list,[8] and the absence of CD's from that list is conclusive based on the *inclusio unius* rule of statutory construction. Plainly, Congress did not attempt to name every type of security then known or to conceive of every variety of financial vehicle which might be devised in the future, and if it had, the ingenuity of the financial markets would be equal to the task of fashioning a new instrument unnamed in the definition. Neither syndicated citrus groves nor oil leases are specifically included in the definition, yet the Court has held such instruments to be securities.[9]

After beginning with broad coverage, Congress carved out limited areas where coverage was believed unnecessary. Unlike the general definition, the list of exceptions is "exhaustive", and is found under Section 3 of the '33 Act, 15 U.S.C. 77c, and Section 3(a)(12), 15 U.S.C. 78c(a)(12), of the '34 Act, describing "exempted securities". CD's are on the first list in Section 3(a)(2), 15 U.S.C. 77c(2), as "any security issued or guaranteed

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[7] H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933) 11.

[8] A.B.A. Br., p. 5.

[9] *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946); *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1934).

by any bank." To the extent CD's are insured by the FDIC, CD's are covered by the language "any security . . . guaranteed by . . . any person controlled or supervised by and acting as an instrumentality of the Government". Likewise exempted are securities of savings and loan associations, such as those involved in *Tcherepnin v. Knight, supra.*

Not even "exempted securities" are relieved from compliance with the antifraud provisions. Section 17(c) of the '33 Act, 15 U.S.C. 77q(c), provides:

> "The exemptions provided in Section 3 shall not apply to the provisions of this section."

Under the '34 Act, "exempted securities" are subjected to the antifraud provisions in Section 10, 15 U.S.C. 78j, and bank securities, other than short-term notes and bankers' acceptances, are not even "exempted securities".

The legislative history of the '33 Act indicates that Congress took the fact of bank supervision into account in exempting bank securities from the registration requirements.[10] No one was then bold enough to suggest that banks should be absolutely relieved of liability under the antifraud provisions.

As stated by the Fifth Circuit in *Lehigh Valley Trust Company v. Central National Bank*, 409 F.2d 989, 992-993 (1969):

> "(T)he fact that Congress exempted from the registration requirements of the Securities Act of 1933 the securities of any '(national bank or other) banking institution * * * the business of which is substantially confined to banking and is supervised by the State * * * banking commission * * *' * * * indicates that Congress was aware of the peculiar problems and strengths of banks resulting from their regulation by state and federal banking statutes. That Congress made no express exemption for banks under the fraud provisions * * * indicates that Congress did not intend any such exemption."

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[10] H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933) 14.

The Government argues that since the same Congress passed the Glass-Steagall Act[11] and the '33 Act, there must have been a *sub rosa* intention to exempt bank securities from coverage altogether. Juxtaposition of time in the passage of legislation is a bizarre basis for statutory exclusion, and if established as a principle of construction, would lead to endless mischief. If anything, the consciousness of current legislation should have led Congress to deal explicitly with the situation of banks in the '33 Act, as indeed it did. Both statutes have been amended and supplemented several times without the claimed exclusion being made explicit.

B. Language

"Security" is defined in Section 2(1) of the '33 Act, 15 U.S.C. 77b(1), as follows:

> "Sec. 2. When used in this title, unless the context otherwise requires—
>
> (1) The term security means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a security, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."[12]

CD's can be aptly classified as bonds, notes, evidences of indebtedness, or investment contracts.

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[11] 48 Stat. 162, ch. 89 (1933).

[12] The '34 Act definition in Section 3(a)(10) 15 U.S.C. 78c(a)(10), is virtually identical, and has been read as such by the Court. The '34 Act definition, however, does not contain the phrase "evidence of indebtedness."

The Government concedes "literal" coverage of CD's by the definition, but Marine Bank and the American Bankers Association resist the obvious. They argue that unless instruments return, or promise to return, profits that vary directly with profits of the issuer, those instruments are not "securities". In other words, fixed income instruments are not securities, and bonds, notes, and debentures, as well as evidences of indebtedness, equipment trust certificates, and preferred stock, should be read out of the '33 Act. A substantial proportion, if not a majority in terms of dollar volume, of securities registered last year with the SEC were fixed income instruments. If nothing else, fixed income instruments fit the "commonly known as securities" language of the definition.

The Government places greatest reliance on the introductory language of Section 2—"unless the context otherwise requires". Whatever was intended by this phrase, it was clearly not meant as a delegation to the courts of legislative power to create broad classes of coverage or exclusion, thus substituting their judgment for that of Congress, as is being urged here. Before the Court overrides the explicit language of the Acts, it should have before it more compelling evidence of Congressional intent than has been presented in this case. The inability of Huston Thompson, then a lawyer in private practice, to envision on the spot the myriad bank instruments sold today should not foreclose the Court from interpreting the language of the Acts according to its plain meaning.[13]

The best interpretation of the "context" language is as a *de minimis* rule applied to particular factual situations.[14] If the

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[13] Mr. Thompson himself stated, referring to the securities covered by the '33 Act, "It would be any kind of security of a national bank." Hearings on H.R. 4314, before House Committee on Interstate and Foreign Commerce, 73d Cong., 1st Sess. 31 (1933).

[14] In *Exchange National Bank v. Touche Ross & Co.*, 544 F.2d 1126 (2nd Cir. 1976), the Second Circuit placed emphasis on the word "requires". Nothing in the federal banking laws *requires* exclusion of CD's from the '33 and '34 Acts. Even the Court in *Bellah v. First National Bank*, 495 F.2d 1109 (5th Cir. 1974), did not hold that CD's were not securities, but merely expressed skepticism in the setting of that case before remanding for a determination of that issue. The Court in *Canadian Imperial Bank v. Fingland*, 615 F.2 465, 470 (7th Cir. 1980), confined its ruling to the particular facts of

"context" in this case can be stretched to include all the federal and state banking statutes and regulations, then it must also be stretched to include the investment in CD's of several hundred billion dollars by tens of millions of investors. That the CD sold to the Weavers was not the only CD sold by Marine Bank, that Marine Bank sold its CD's to the public as investments, and that the Weavers were not in the business of making loans to banks, must also be considered as part of the context.[15]

C. Purposes

The '33 and '34 Acts regulate disclosure and prohibit frauds concerning securities. The intrinsic worth or "safety" of securities is not their concern, and, as this Court stated in *SEC v. Howey, supra,* is not a proper basis for exclusion from coverage. Even the terms of "safe" securities can be misrepresented. Even "safe" securities can be sold for too much, bought for too little, or otherwise dealt with in a fraudulent manner.

With safe, regulated securities excluded from coverage, the '33 and '34 Acts would cease to apply to treasury securities, state and municipal securities, securities issued or guaranteed by Federal and Government National Mortage Associations, the Farmers Home Administration, public utilities, insurance companies, common carriers, and many others.

Nor does such a measure withstand scrutiny. "Safety" in the context of the financial markets is a relative concept, heavily

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that case. In withdrawing its prior opinion, the Court in *MacKethan v. Burrus, Cootes and Burrus,* 545 F.2d 1388, 1391 (4th Cir. 1976), said "Yet we deem it appropriate to emphasize that we are not taking any position on the question (1) whether the District Judge was justified in ruling as a matter of law, instead of submitting to the jury, the issue whether NS&L certificates of investment were "securities" within the meaning of Section 3(a)(10) of the ('34 Act). . ."

[15] The "context" might also include the fact that banks issue a variety of instruments to the public, some of which are insured, some of which are not, and some of which are partially insured. "Variable rate notes," CD's whose interest rate fluctuates according to certain indices, and "repurchase agreements," whereby investors buy an interest in a pool of money market instruments, closely resemble mutual funds. The "context" might also include the fact that banks compete aggressively for capital, using full page ads, songs and jingles, celebrity spokespersons, "free" kitchenware, and "finders fees".

dependent on the circumstances. During the depression, having money in a "good" bank (as opposed, one assumes, to a "bad" bank), may have been safe, but compared to the stock market (or a "bad" bank), even a mattress was safer. Times have changed. If the Weavers still held their CD today, after giving effect to inflation and taxes, their investment would have lost roughly thirty percent of its initial value. Sophisticated bond traders, dealing in even "safer" securities, have done as poorly. One man's safety is another man's financial debacle.

A corollary purpose of the '33 and '34 Acts is the protection of investors. These Acts were were passed to remedy the evils in securities sales and trading that contributed to the market collapse and to the public lack of confidence in the financial markets. On the other hand, nothing in these Acts or their legislative history reveals any intention to protect banks or other commercial lenders from borrowers.

Since protection of commercial lenders was not a purpose of the Acts, some courts have adopted the "commercial/investment" dichotomy. As stated by the Court in *Sanders v. John Nuveen & Co.*, 463 F.2d 1075, 1080 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972), in distinguishing investment and commercial note transactions:

> "When a prospective borrower approaches a bank for a loan and gives his note in consideration for it, the bank has purchased commercial paper. But a person who seeks to invest his money and receives a note in return for it has not purchased commercial paper in the usual sense. He has purchased a security investment."

Basically, a debtor/creditor relationship is something different from the "ordinary concept of a security."

Yet where securities were pledged to a bank to secure a loan, as in *Rubin v. United States*, 100 S.Ct. 698 (1981), the federal securities laws were held to apply. Presumably, had the bank been charged with violating the federal securities laws, as in this case, coverage would also have existed.

II. The Economic Realities Are That CD's Are Securities.

When investors purchase CD's, they are doing something more than parking their capital at a bank and getting a receipt, like some kind of bailment.[16] CD's more closely resemble treasury bonds than "demand deposits" or "safe deposits" that pay no return. The investment features are predominant. Money market funds, 22% of whose assets in the aggregate consist of CD's, invest in CD's primarily for the return. So does everyone else.

CD's compete with, and are offered as attractive alternatives to government obligations, utility bonds, money market funds, and wrap-around annuities, all indisputedly securities. The nature of an instrument, not its origin, should be determinative. Moreover, in a review of contemporary financial markets, Morris Crawford, Jr., Chairman of the Bowery Savings Bank, New York's largest, wrote:

> "While it appears that savings banks do not offer a significant hedge against inflation, they have competed aggressively and successfully over the past ten years with such other investments as stocks, bonds and mutual funds."[17]

The vehicles for such competition by savings banks were CD's and savings accounts.[18]

As mentioned earlier, the Court has held savings accounts of a state regulated savings and loan association to be securities.[19] Although these securities, typical of mutual savings and loan

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[16] CD's can no more accurately be described as "currency deposits", the phrase used by Marine Bank, than corporate securities can be described as "currency bonds" or "currency stocks".

[17] M. CRAWFORD, "The Bedrock," in LEVITT, ed., HOW TO MAKE YOUR MONEY MAKE MONEY 17 (1981).

[18] As stated by the Court in *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1934), a financial instrument may be classified by the instruments against which it competes for investors.

[19] *Tcherepnin v. Knight, supra.*

associations, entitled holders to a vote, it is doubtful that the voting feature was of any material investment significance or was ever a strong inducement for purchase. Many other securities, including the majority of securities listed in Section 2(1) of the '33 Act, 15 U.S.C. 77b(1), do not involve voting.

In the past, when the Court spoke of "economic realities", it was referring in part to the *Howey* test, as applied in *United States Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975). That test, investment in a common enterprise with the expectation of profits from the efforts of others, is readily met by the Weavers' CD. The money invested in banks does not remain at rest, but is accumulated and reinvested for a return. Investment in bank instruments is substantially similar to investment in a pool of loans and securities arranged and purchased by the bank. A bank is every bit the common enterprise that the savings and loan association was in *Tcherepnin v. Knight, supra.*[20]

The investor in bank securities, as opposed to demand deposits, that are made for safety and convenience, expects a return at the rate agreed upon, as in the case of CD's, or at the rate determined from time to time by the bank's board of governors, as in the case of savings accounts.[21]

III. Bank Regulation Does Not Substitute For or Conflict With the '33 and '34 Acts.

CD's, unlike involuntary, non-contributory interests in labor union pension funds, are a staple of the financial markets. To acquire a CD, one must invest capital, not labor. Those acquiring

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[20] By use of the term "deposit", banks seek to preserve the illusion that all its "deposits" are sitting in a vault somewhere. This, of course, is nonsense. All but a small fraction are out somewhere working to earn more money.

[21] The District Court in *Ayala v. Jamaica Savings Bank, supra*, expressed the view that since most of the CD's were FDIC insured, the investors were not looking to "*others*" for profits. However, the FDIC appears for all intents and purposes to be an "other". Such insurance is not the equivalent of the investor mixing his own labor with the enterprise. Federal insurance does not prevent Government National Mortgage Association-backed instruments, for example, from being considered "securities".

CD's, unlike labor union members, have a choice of a variety of financial instruments. CD's, unlike pension rights, are assignable, and in institutional circles, are freely traded and exchanged.

Were this not sufficient to distinguish the interests involved in *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979), from CD's, it can be further said that the federal laws governing pensions provide substantive individual rights and remedies.[22]

An examination of the federal banking statutes and the regulations issued thereunder reveals that there are no individual rights or remedies. This is a far cry from the rights to bring civil actions and to obtain damages, rescission or restitution under the '33 and '34 Acts. Nor do the federal bank agencies have the power to order or cause these remedies.

Under the statutes applicable to Marine Bank, for example,[23] the FDIC may, if it detects "unsafe or unsound" practices or violations of regulations, issue a "notice of charges". At least thirty days later a hearing is held, and thirty days after that a cease and desist order may be issued. A temporary cease and desist order may be issued where the perceived misconduct "is likely to cause insolvency or substantial dissipation of assets or earnings of the bank or otherwise seriously prejudice the interests of its depositors" prior to completion of the more lengthy cease and desist order proceedings. Officers may be removed for engaging in unsafe or unsound practices, or for breaches of fiduciary duty to the bank where the bank has or probably will suffer "substantial financial loss", the interests of depositors generally is "seriously prejudiced" or the officer has profited personally.

Whether these provisions benefit a defrauded individual is doubtful. They are primarily designed to protect the institution as opposed to those dealing with it. What is certain is that they provide no relief for damage already done. Nothing permits the bank agencies to penalize or obtain remedies from the bank institutions themselves, other than to deny insurance coverage,

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[22] See 29 U.S.C. Sec. 1132.

[23] 12 U.S.C. (Supp. III) 1818.

thereby possibly injuring those defrauded. They fall far short of the fines, forfeitures, criminal sanctions, and equitable remedies under the '33 and '34 Acts.

The same may be said for the regulations, whose purpose is largely to prevent, or at least regulate, economic competition among the banks. Although the regulations prohibit misrepresenting "interest" and "deposit contracts", they do not prohibit misrepresentations of anything else.[24] They do not prevent the bank from simply omitting to state material facts. Most importantly, they provide no remedies whatsoever.

The federal banking statutes and federal securities statutes were, as all seem to agree, passed for different purposes; the first to insure the financial stability of banks, and the second to insure full and fair disclosure in the financial markets. In no way can these sets of statutes be considered substitutes for each other. The bank agencies do not have the authority, resources, or motivation to police the financial markets. Their charter is to prevent bank failures either through poor management or through a "run on the bank" set in motion by a loss of confidence. Unless the stability of the institution is jeopardized, the bank agencies are not concerned with individual transactions.

Ironically, while the Government argues to the Court that the protections of the federal securities laws are unnecessary because of the Glass-Steagall Act, the Justice Department is arguing to Congress that the protections of the Glass-Steagall Act are unnecessary because of the protections of the federal securities laws.[25]

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[24] See, e.g. 12 C.F.R. 329.8(f), which applies to Marine Bank.

[25] On September 10, 1981, John C. Filippini, Chief, Legislative Unit, Antitrust Division, United States Department of Justice, in a speech to the Federal Bar Association, said, "On July 8, 1981, Assistant Attorney General Baxter testified before the House Judiciary Committee Subcommittee on Monopolies and Commercial Law concerning the structure of the financial services industries . . . The Department of Justice believes . . . that securities and other forms of government regulation put in place after the Glass-Steagall Act's enactment in 1933 may largely have lessened the potential for abuses in both commercial banking and securities activities that led to passage of that Act. If this belief is accurate, Glass-Steagall prohibitions may be eliminated or substantially reduced without affecting the stability and soundness of the commercial banking system."

This apparent lack of coordination, apart from the obvious conflict, demonstrates the folly of giving the '33 and '34 Acts a kaleidoscopic character whose meaning shifts and changes depending upon what other laws might be on the books at any given time.

The '33 and '34 Acts should stand alone, made clear by their own words, without an exhaustive search of the United States Code. Aside from occasional cross references to the Internal Revenue Code, nothing in those Acts or in their legislative history reveals any intention that they be subservient to any other act of Congress. Indeed, Section 16 of the '33 Act, 15 U.S.C. 77p, provides. "The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity."[26] The express words and purposes of those Acts should enjoy a strong presumption, and should be overridden only by something even stronger. The sparse bits of ambiguous legislative history put forth by the Government do not begin to justify reversal of express legislative determinations.

What we are faced with in this case is not the prospect of "duplicative and unnecessary regulation," but rather the simple requirement that when banks take other peoples' money based on the promise of a return, or when they otherwise deal with instruments thus created, they tell the truth. Most banks are not burdened in the least by that requirement.

There is no reason why savings and loan associations should be held to this requirement while commercial banks, such as Marine Bank, remain immune. The fears of bank agencies that this requirement "would inhibit the ability of banks to attract deposits" and "unduly raise compliance costs"[27] do not justify

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[26] See also Section 28(a) of the '34 Act, 15 U.S.C. 78cc(a).

[27] As stated by the SEC in its brief in *Meason, supra*, "certain banks are already subject to affirmative disclosure requirements under Section 12(i) of the Securities Exchange Act, 15 U.S.C. 781(i), which requires that banks with publicly-held common stock file periodic reports, similar to those prepared by other publicly-held cororations, with the appropriate federal bank regulatory agency. The regulations adopted by the bank regulatory agencies pursuant to Section 12(i) of the Securities Exchange Act include requirements that the banks file current reports within ten days after the close of the month in which

overriding express Congressional mandates. Nor is there anything in the federal banking laws requiring or authorizing banks to raise capital by means inconsistent with the federal securities laws.

IV. Identical Language In Closely Related Statutes Should Not, As Urged, Be Given Opposite Meanings.

The SEC argues that under the Investment Company Act of 1940, 15 U.S.C. 8a-1 et seq. (" '40 Act"), CD's are securities and that the Court should either so indicate or else restrict its opinion so that coverage under the '40 Act might still be claimed. The definition of "security" in the '40 Act is identical, word for word, to the definition in the '33 Act. One of the decisions relied upon by the Government to support its '33 and '34 Act position arose under the '40 Act.[28] In essence, the SEC is asking that identical language in closely related and interdependent statutes be given opposite interpretations, and that CD's when bought and sold are not "securities", but once they come to rest and are held, they are magically transmuted into "securities". Congress deserves greater credit for logic and consistency. There is no evidence of Congressional intent to support such an approach.

The reasons given for considering CD's as securities under the '40 Act are reasons for considering CD's securities under the '33 and '34 Acts as well. It is not the intrinsic "safety" of an instrument that matters, but what is done, said, or not said about it, that concerns the federal securities laws.

This is not to say that the only partially expressed fears of the SEC are unfounded. A holding that CD's are not securities would create a gaping loophole not only in the '40 Act, but in

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certain events occur. *See* Form F-3, 12 C.F.R. 11.43; Form F-3, 12 C.F.R. 206.43; Form F-3, 12 C.F.R. 335.43. Defendants do not claim that these affirmative disclosure requirements have imposed intolerable burdens, caused a 'panic' or a 'run' on any banking institution subject to those provisions, or interfered with any needs of the banking industry for confidentiality."

[28] *Drovers Bank v. SFC Corporation*, 1452 F.Supp. 580 (N.D. Ill. 1978).

several provisions of the Internal Revenue Code that are dependent on '40 Act coverage. The result, in the absence of new legislation, would be a dramatic restructuring of the financial markets, an explosion of "offshore" funds, a huge loss of tax revenues, and colossal uncertainty.

Greatly simplified, Section 1246 of the Internal Revenue Code discourages money market funds from locating in tax havens, avoiding income taxes, and then remitting income in the form of capital gains to shareholders who redeem their stock, by taxing those gains as ordinary income. Such entities, known as "foreign investment companies", are defined as foreign corporations engaged primarily in the business of investing in "securities" as defined under the '40 Act. If CD's are not "securities" under the '40 Act, a money market fund could locate in a tax haven, invest primarily in CD's, and offer yields roughly fifty percent greater than other funds.[29]

Despite the financial incentive, the movement of money market funds offshore has not occurred because the financial markets have assumed and become comfortable with the knowledge that CD's are securities. Thus, in the financial markets, if not in western Pennsylvania, CD's are "commonly known as securities".

V. The Fraud Upon The Weavers Was of The Type Intended To Be Covered By The '33 And '34 Acts.

In *Superintendant of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971), there was nothing intrinsically wrong with the treasury securities employed as part of that fraudulent scheme.[30] Similarly, the intrinsic worth of the Weavers' CD did not prevent a scheme to deprive them of its value in exchange for something worthless.

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[29] Havoc would also be played under Subchapter M of the Internal Revenue Code, which deals with taxation of investment companies, and is also tied in to the provisions of the '40 Act.

[30] It is instructive that the regulating agency involved in that case resorted to the securities laws for a remedy.

The extent to which Marine Bank can minimize its role in this scheme is limited. Marine Bank was the principal promoter and beneficiary of the scheme. Its position is totally different from that of the accountants in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), who failed to uncover a fraudulent scheme, but did not themselves benefit from it. Even if Marine Bank did not know precisely what the Weavers were getting, it knew precisely that whatever it was had little or no value.

Marine Bank suggests that the Weavers should have known that any person needing outside collateral is in desperate financial condition.[31] But not all collateralized loans fail. Few fail soon as the collateral is delivered. The Weavers undoubtedly thought there was some risk involving the pledge of their CD, but not an ironclad certainty that their CD would almost instantly disappear.

Marine Bank suggests that it could not have disclosed material facts to the Weavers concerning the financial condition of the slaughterhouse or concerning Marine Bank's involvement since to do so would violate duties of confidentiality.[32] But self-imposed duties of confidentiality cannot be preferred over the duties under the federal securities laws, and must be qualified to that extent.

It is important here to emphasize the advantages of the anti-fraud provisions of the federal securities laws over the rules of common law fraud. The former not only establish a nationwide rule for financial markets, but, unlike common law fraud, establish liability for non-disclosures.[33] Securities transactions are held to a higher standard than *caveat emptor*, as Congress believed they must be to maintain confidence in the financial markets.

Although not principally concerned with the agreement whereby the Weavers were entitled to fifty percent of the profits of the Piccirillo slaughterhouse, one hundred dollars a month, and grazing rights, in exchange for their pledge to Marine Bank ("Piccirillo Agreement"), we must note that the Piccirillo Agreement certainly appears to have all the indicia of a "profit-sharing

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[31] M.B. Br. fn. 22.

[32] Id.

[33] See L. LOSS, SECURITIES REGULATION 1434 (2nd ed. 1961).

agreement" or "investment contract".[34] It bears little resemblance to a commercial lending agreement. No commercial lender would accept such terms, and the Weavers were not in the business of entering into profit-sharing agreements. The Agreement easily passes all the tests formulated by the American Bankers Association to be applied to CD's, just as CD's easily pass all the tests formulated by the Government to be applied to the Piccirillo Agreement.

VI. Conclusion.

Investors acquire and dispose of securities for a variety of reasons, safety being only one. In all cases, investors wish to receive what they reasonably expected without constant concern about what is being withheld or concealed. When they are cheated, they want entitlement to a remedy. The federal securities laws were intended to fulfill these needs and desires. The federal banking laws were not.

This case is not the occasion to relieve bank instruments of the requirements of full and fair disclosure. With the Depository Institution Deregulation Act of 1980 coming into effect, with further attempts being made to eliminate regulation, and with all the other rapid changes now taking place in the financial markets, the standards and assurances provided by the federal securities laws are needed more than ever.

If CD's were subjected to a "blind" test without reference to who or what the issuer was, the result would be automatic. CD's are widely offered to the public as attractive investments. They easily meet the *Howey/Forman* tests. They fit comfortably within the definitional language. No logical reason exists for commercial bank securities to be given a preferred status over those of savings and loan associations or over those of the federal government itself.

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[34] Instruments are not typically described by the consideration given for them. The Piccirillo Agreement is no more a "loan guarantee agreement", the label used by the Government, than stock options are "money payment agreements".

For all the foregoing reasons, as well as those advanced in the brief of the respondents, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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